A super house strategy

The Transfer Balance Cap has opened a potentially useful super strategy.

Summary: *Retirees may be able to exploit the Transfer Balance Cap to their advantage.*

Key take-out: *Members of a couple can make an extra contribution of up to $300,000 each tax-free from the sale of a home they have owned for at least 10 years.*

Canberra has a reputation for slamming the door on any perceived over-generosity created by a particular policy – only to inadvertently open another two. Just consider the opportunity housing now represents since the introduction of the $1.6 million super Transfer Balance Cap.

Traditionally, I've advocated that the 'perfect' position is debt-free home ownership at age 65, and (if possible) as a couple to aim to have $3.2m in super. This will provide an indexed, minimum annual tax-free income of $160,000 a year to play with for some considerable period of time (at least for the remaining years!) – a highly favourable outcome.

While not everyone has the potential to get near the $1.6 million super Transfer Balance Cap (TBC), it is my belief that we should (to paraphrase Norman Vincent Peale), "aim for the moon … even if we miss, we will be amongst the stars".

However, the opposite is also true, with some very successful people now needing advice on how to maximise their investment returns in a tax-effective manner once the cap has been reached.

Scott Morrison's budgetary 'brainwave' two years ago to cap super at $1.6m per individual has left many hard-working people stranded midway through a sensible superannuation strategy. They are not certain of what they can do to 'fix' their retirement savings issues.

Furthermore, the proposed carnage on investment properties which is proposed by a likely new ALP government will send shivers down the spine of already jittery investors.

All of this leaves rational people wondering about which strategies they can use to grow and preserve their wealth.

How the strategy may work

Canberra has given those among us who are over 65 a free-kick to downsize our homes.

A couple can now each contribute up to $300,000 extra from the sale of their home to fund retirement tax-free, which is a logical outcome. At a conservative 5 per cent per annum return, that could mean an extra $30,000 a year for the couple to spend during retirement – although the ASX real return over the last 30 years for has been almost twice as high.

However, there is a catch: you must have owned the house for a decade. Therefore, a strategy for those between 50 and 54 years of age might be to consider upgrading to a highly desirable suburb and staying put for the next 10 years to take advantage of this largesse, while also enjoying a fantastic tax-free capital gain. Bear in mind though, that this age range can also be the career 'death zone', in which many successful people are made redundant or retire early. As a result, mortgages should be avoided.

Another approach to fixing the gap is to consider using any taxable investments to significantly upgrade the family home, or move into a much better house once the magic $1.6 million in superannuation has been reached. No political party in peacetime, in my view, would risk removing the capital gains tax-free status on the family home. So, this is a fantastic way of generating tax-free gains.

But it presents an interesting conundrum: at a time when people traditionally downsize, it may very well be a significant advantage (or an estate advantage) to upsize the home. It may well be a great opportunity at the moment, particularly with housing prices on the decline.

My view as an economist, however, is that the housing downturn is temporary (market downturns are generally always temporary, as are the market good times). The global economy is just doing too well at the moment to allow this downturn in housing to continue, despite the rhetoric to the alternative.

Such an approach, therefore, is principally a Melbourne and Sydney strategy, given the ridiculous housing prices paid in elite suburbs. However, there may also be significant opportunities in the other capital cities.

A couple aged over 60 with more than $3.2m in super may benefit significantly by withdrawing their excess above the $3.2 million combined TBC threshold, and use that capital to buy a larger home in a suburb such as Toorak or Potts Point, or massively increase the capital value of the home in which they already live. Over time, the (tax-free) value of the property – based on historical experience – will increase, thereby turbo-charging their estate, as super did prior to the $1.6 million super TBC!

Putting it into practice

The following, actual client example outlines a strategy recently employed by an eastern seaboard-based couple (details shared with their permission):

Their free-hold family home was built pre-September, 1985, which means it is not subject to capital gains tax, and will remain CGT-free, even if they no longer live there ever again!

This home is much loved (it is where they raised their children and grandchildren) and they were reluctant to sell it to upgrade.

With $7 million in their SMSF ($3.8 million of that in excess of their combined TBC threshold and subject to income tax and CGT within their SMSF since 1 July, 2017 – courtesy of the ill-considered and retrospective TBC legislation), they have decided to purchase a new principal residence.

Their new home, a brand-new beachfront property with a purchase price of $4 million, will be funded from their $3.8 million SMSF excess benefit. They are both over the age of 60, and their super withdrawal is tax-exempt. As their nominated principal residence, the new property will be CGT-exempt (regardless of when it is purchased), as will their former home, which they will retain as a second ‘city’ residence.

While their former home will now be subject to land tax, withdrawing the $3.8 million excess from their SMSF will save them approximately $28,500 a year in tax (i.e. $3.8 million x estimated income of 5 per cent a year x 15 per cent super fund tax).

Add to the fact that, should they decide (at some later point) to sell either or both properties, all sale proceeds will be completely CGT-exempt. In addition, they still have $3.2 million in their SMSF, providing them with – as a minimum – $160,000 a year in tax-free retirement income, not to mention the use of two beautiful homes.

Depending on which property they later sell, at that time they may be able to top up their super balances to the tune of $300,000 each!

Another potential strategy

For those who came late to the super party – or those who were not lucky enough through health or personal circumstances to have built a decent superannuation asset – there is also the option for homeowners to access a reverse mortgage.

While I am not a huge fan of these products due to the rate of interest charged by the banks, they do provide a service, particularly at a time when we should all have the dignity of a reasonable income, before settling into retirement care.

There is also the more attractive, but little-known Pension Loan Scheme offered by the Federal government, whereby home-owning age pensioners can supplement their income with additional age pension payments from Centrelink. The interest rate is 5.25 per cent per annum (versus the banking industry's average of 8.5 per cent per annum), with no establishment or monthly fees.

It is vital to note that reverse mortgages and the government Pension Loan Scheme must be repaid (including the capitalised interest on these loan amounts) whenever the property is eventually sold.

Nevertheless, current reality reinforces my long-held view that despite constant government meddling with the rules, super remains the best place to invest (as much as you can afford) up to the ill-considered legislated $1.6 million TBC per person. This is a crucial pillar for a happy retirement.

As we also all need to live somewhere, the other pillar of a happy and comfortable retirement is the ability to fund a suitable home.

Having both of these assets covered will provide access to strategies to move funds between super and your home – and even back to super (thanks to the new Downsizer Super Contribution rules) – and ensure with some careful planning that you have the best retirement possible.

Maybe the constant government tinkering is a good thing after all. It helps us to think outside the box!

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